

# **FRESNO CITY COUNCIL FINANCE AND AUDIT COMMITTEE**

**Councilmember Lee Brand, Chair  
Councilmember Clint Olivier, Vice Chair  
Council President Blong Xiong**

**October 8, 2013**

**TO: Finance and Audit Committee Members  
FROM: Lee Brand, Chair**

## **FINANCE AND AUDIT COMMITTEE FINDINGS AND RECOMMENDATIONS**

For the past four months, I have extensively researched the operational and financial issues at the Convention Center. I have reviewed and examined hundreds of pages of documents. The Committee has conducted two public meetings to ask City officials; SMG officials and other interested parties questions raised from the July 25, 2013, Council meeting. Nearly all of the initial and follow up questions have been answered through written responses or communications at the August 12<sup>th</sup> and September 9<sup>th</sup> Committee meetings. I want to thank Council members Xiong and Olivier for their participation and help in the two previous Committee meetings. I also want to thank City Manager Bruce Rudd, City Attorney Doug Sloan and SMG officials for their assistance.

I will offer my findings and recommendations to be reviewed and voted on by the Committee as a whole. If approved by at least two committee members, these findings and recommendations will be presented to the full City Council at the October 24<sup>th</sup> meeting.

### **Findings:**

1. There are no opportunities at this point in time to refinance any of the existing Convention Center debt issuances that would result in any significant debt service costs.
2. City decisions to continue funding major capital improvements at the Convention Center Complex after the final decision to build Savemart Arena are questionable. Although there was certainly the need to upgrade complexes, some consideration should have been made to consider possible sale of one or more of the venues. At this point in time, bond encumbrance's far exceed market value of venues making it economically unfeasible to sale any of the venues for any time in the foreseeable future.

3. The Net General Fund subsidy for the Convention Center has averaged approximately \$8.0 million per year for the past 6 years and would be even higher if the City was still funding the Convention Visitors Bureau (CVB) and if extended accounts payable (i.e. APES fees) owed to the City was brought current.
4. For the past three years, SMG has carried forward Accounts Payable in the \$1.5 to \$2.0 million range including \$600,000 to \$750,000 owed to the City of Fresno. As of 6-30-13, SMG owed the City approximately \$735,000. Carrying excessive accounts payable by SMG has understated the true Net General Fund Subsidy for the past 4 years.
5. In City staff reports in 2004 and 2008 regarding support for SMG management of the Convention Center, representations were made that the Net General Fund Subsidy would be reduced \$6 million. In fact, the Net General Fund Subsidy actually increased at least \$2 million under SMG's management.
6. From 2004 through 2008 SMG accrued approximately \$2 million in employee benefit costs and failed to follow contractual procedures/remedies to request mid term budget amendments from the City. The contract extension approved in 2009 was settled for \$1 million. The City agreed to repay at \$100,000 per year. The City currently owes SMG \$500,000.
7. Of the four venues at the Convention Center, Selland Arena and the Saroyan Theatre generate the biggest losses. In 2012, Selland Arena lost about \$700,000 and Saroyan Theatre lost about \$300,000.
8. The total approximate amount of deferred capital improvements at the Convention Center complex is \$7.9 million. There is currently no capital reserve plan to address this issue. Failure to address needed capital improvements will exacerbate the financial losses for the Convention Center.
9. There is not a reliable methodology to accurately track Room Tax (T.O.T.) and measure the economic impact in the community resulting from Convention Center events.
10. SMG does provide detailed monthly reports including financial reports to the City Manager every month. These reports, however, have not been released to Council members.
11. In 6 of the past 9 years, SMG has failed to meet their budget benchmarks including the past 2 years. SMG's failure to meet their budget benchmark enables the City the opportunity to cancel the management contract pursuant to Section 10.2 of the 2009 contract between SMG and the City.

12. The management fee provision in the current contract with SMG increases every year via a CPI index increase irrespective of the actual performance of SMG. In 2005, over 500 events (figure includes City events) were completed at the Convention Center and the management fee was \$160,000. In FY2013, only 251 events were completed but the management increased to \$191,800.
13. There is a disconnect in the relationship between SMG and the Convention Visitors Bureau (CVB). The City discontinued funding CVB 4 years ago. CVB funding is assessed directly from member hotel/motel owners and does not have the same focus as it did when the City provided \$600,000 plus per year in funding.
14. The City is not realizing the full potential of outdoor advertising on Convention Center buildings and other City owned properties. There are revenue opportunities for selling outdoor advertising space to Convention Center vendors and sponsors at strategic locations at Convention Center buildings.
15. The question of a potential conflict of interest with SMG managing both the Save Mart Center and the Convention Center has not been satisfactorily answered. SMG manages Convention Centers and other similar venues worldwide and Fresno is the only City in their management portfolio where they manage for both two competing, separate entities in the same city.

#### **Council Options for Management of Convention Center:**

1. The Council has three primary options:
  - 1) Do nothing and continue on with SMG managing the Convention Center with no contractual changes;
  - 2) Re-negotiate the contract with SMG including subcontracts to make substantive changes in the contract that will provide the City more control of Convention Center operations and a significant reduction in the annual Net General Fund subsidy. Under this option, SMG and subcontractors would have to voluntarily agree to any negotiated contract changes; or
  - 3) Cancel the contract with SMG and request the City Manager/City Attorney prepare a Request for Proposal (RFP) for management of the Convention Center complex.
2. To implement option 3 will require the City Attorney send a letter of intent to cancel the management contract between SMG and the City.
3. Financial consequences of each option:

- 1) If nothing is done with the existing contract with SMG, the City General Fund will continue to subsidize operations in the \$7.0 to \$8.0 million per year range. There is no plan to address the estimated \$7.9 million in capital improvements needed for all of the Convention Center venues. There is also no plan to remedy the \$1.5 to \$2.0 accrued accounts payable carried by SMG. Even with improved market conditions, deteriorating venues at the Convention Center will be unable to compete in the market place;
- 2) The financial benefits of selecting option two will depend on the specific changes to the SMG contract as well as the willingness of subcontractors to voluntarily renegotiate their contracts. SMG officials have met with the City Manager and have been open to consider both financial concessions and a substantive contract amendment pursuant to recommendations suggested by Chair Brand at the September 9<sup>th</sup> Finance and Audit Committee meeting. The following concessions were discussed at the September 9<sup>th</sup> meeting:
  - a) Reduce management fee by approximately \$50,000 per year
  - b) Reduce repayment of \$500,000 from \$100,000 per year to \$50,000 per year with the re-payment period extended 5 years.
  - c) Reduce salary and benefits by 5-10% for an approximately savings of \$100,000 to \$200,000 per year
  - d) Eliminate management fee bonus provision for approximate savings of \$45,000 per year (note: this bonus has never been paid)
  - e) Expand efforts for naming rights deals to increase annual income with potential revenue increase of \$50,000 to \$200,000 per year
  - f) Implement operating efficiency studies with a potential savings of \$50,000 to \$100,000 per year
  - g) Re-negotiate subcontractor compensation with a potential savings of \$50,000 to \$100,000 per year and
  - h) Work with City in risk sharing business plan to expand business and increase revenues with potential of \$100,000 plus per year
- 3) The exact financial benefit of cancelling the SMG contract and initiating an RFP will not be known until the City can develop the RFP format and examine the proposals submitted. It is estimated that a new RFP implementing recommendations outlined in the September 9<sup>th</sup> meeting and additional items discussed informally (i.e. outdoor advertising ordinance amendment) could yield Net General Fund Subsidy savings between \$500,000 to \$1,000,000 per year.

### **Final Recommendations**

Based on a thorough evaluation of Convention Center operations and finances I am recommending that the Finance and Audit accept the findings offered in this document and approve the recommendations below:

1. Request the City Attorney/City Manager send a notice of cancellation to SMG advising them of our intent to cancel their management contract for the Convention Center and prepare an RFP for management of the Convention Center Complex. SMG will be encouraged to submit a proposal in a new RFP

And/or

Request City Manager/City Attorney negotiate a substantive contract amendment with SMG and subcontractors that will result in a substantial reduction in the Net General Fund Subsidy (\$400,000 plus savings per year) and significant changes in the contract that will increase City profitability, accountability, transparency and increased involvement and oversight by the City (see Exhibit A). Request City Manager to present deal points and contract amendment to Council at the October 24<sup>th</sup> Council meeting.

**Note: I am recommending that the Committee present both options for the Council to decide which option is best for the City. If the proposed contract amendment presented at the October 24<sup>th</sup> Council meeting does not meet the City's financial and contractual needs, I will recommend cancellation of the contract with SMG and initiation of the RFP process.**

2. Recommend that City hire an industry consultant with experience in evaluating Convention Center management operations to conduct an independent review of the Convention Center operations and finances and assist in the development of the RFP;
3. Draft an amendment to City sign ordinance to allow for outdoor banners and electronic billboard signs on City owned properties;
4. Working with industry consultant, examine potential uses and revenue opportunities of Chukchansi ball park during the off season when the City has the right to use the facility;
5. Request City Manager/City Attorney develop Convention Center commission agreement to incentivize CVB or any outside agency with an interest in promoting events at the Convention Center to expand existing marketing efforts of SMG;
6. All realized savings emanating from the implementation of either a substantive contract amendment with SMG or through an RFP shall be directed to a Capital Improvement Reserve Fund for Convention Center improvements until such time that substantial progress has been made on Convention Center capital improvements. All funding shall be subject to a majority vote of the Council;

7. The City and SMG or a future Convention Center operator (via an RFP) reconcile all current accounts payable through negotiated re-payment or write off to zero balance prior to the start of operations on or before July 1, 2014. All future budgets shall reflect true costs and accurately state the Net General Fund Subsidy; and
8. City to develop more accurate tracking methodology of room tax revenues and the measured economic impact on the community through a joint effort with the CVB and Convention Center operator.
9. City Attorney to request copy of SMG contract with Save Mart Center and examine document to determine potential conflict of interest issues. From this research, City Attorney to recommend provisions in contract amendment that can better address potential conflict of interest issues.

**Vote on findings and recommendations**

**EXHIBIT 'A'**

**Recommendations for Contract Amendment between City and SMG**

1. Mandatory independent audit of all operations every 3 years or as needed, at the sole discretion of the City. If no financial irregularities are found, the City shall pay for the audit;
2. Mandatory internal City audit on a limited scope every year or as needed;
3. The City of Fresno to have sole discretion to approve or disapprove of any General Manager selected by Contractor to manage the Center. City Manager to review and recommend General Manager choice of Contractor to be affirmed by a majority vote of the Council. Contractor may terminate General Manager without the consent of the City and shall advise the City immediately of such action. The City, as affirmed by a majority vote of the Council, shall have the right to direct Contractor to remove General Manager, **with cause**, during the term of the contract with a written 30-day notice to Contractor;
4. City to have more control and involvement in Convention Center operations including but not limited to booking events, product sales, and subcontract services;
5. Contractor shall not exceed the approved annual budget net operating deficit (excluding debt service and capital expenditures) without the approval of the City and under circumstances within Contractor's control; **Contractor shall be responsible for the overage**;
6. Contractor to bring all accounts payable current no later than July 1, 2014 and to never allow any accounts payable item to exceed 90 days. Contractor must submit accurate budgets to reflect all true costs. Failure to keep accounts payable items under 90 days can result in contract cancellation or penalties assessed against management fees;
7. Convention Center Manager to provide detailed monthly reports to Council;
8. Mandatory annual report to Council during budget hearing of Fiscal year approved budget vs. actual budget data;

9. Implementation of new risk sharing business plan for Convention Center operations;
10. Establish closer and more strategic relationship between Convention Visitors Bureau (CVB), Contractor and the City; and
11. Establish 5-person oversight board consisting of one CVB board member or director, one Fresno Chamber of Commerce member, one Hotel/Motel industry member, one Council member and the city Manager of Fresno;
12. Contract provisions be included to safeguard and eliminate potential conflict of interest issues between the management of the Convention Center and the Save Mart Center via written policies and procedures; and
13. Any other item that the City Attorney or City Manager deems necessary to improve contract terms for the City.